SPECIAL AUDIT OF THE

PENNSYLVANIA DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

AND THE

PENNSYLVANIA DEPARTMENT OF GENERAL SERVICES

PURCHASE OF LAND FOR A TRACKED-VEHICLE MANEUVER TRAINING AREA IN CLEARFIELD COUNTY

CONTENTS

November 27, 2001

The Honorable Mark S. Schweiker
Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120

Dear Governor Schweiker:

The Department of the Auditor General has completed a special audit of the proposed purchase by the Department of Military and Veterans Affairs (DMVA) and the Department of General Services (DGS) of land in Clearfield County to be used by the Pennsylvania National Guard as a tracked-vehicle maneuver training area. The audit covered the period from May 1995, when DMVA began its search for suitable land in Clearfield and Centre Counties, through November 2000 when DMVA announced its cancellation of the purchase. The Department of the Auditor General performed the audit under the authority of Section 402 of The Fiscal Code, 72 P.S. § 402, which states: "Special audits of the affairs of all departments, boards, commissions or offices, may be made whenever they may, in the judgment of the Auditor General, appear necessary..."

Except as discussed in the following paragraph, our audit was performed in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. Our audit consisted of tests and procedures which we considered necessary under the circumstances to evaluate compliance with applicable laws and

regulations, the adequacy of internal controls, and whether applicable Commonwealth agencies exercised due diligence in committing public funds to this land purchase. Our approach included reviews of documentation and inquiries of the management and staff of DMVA, DGS, the Department of Environmental Protection (DEP), and outside contractors assisting in this transaction to obtain an understanding of applicable policies, procedures, regulations and internal controls. We also examined the six agreements of sale, environmental site assessments, and title searches related to the proposed purchase.

During the course of our audit, we became aware of an earlier investigation of the proposed purchase performed by the Pennsylvania Office of Inspector General (OIG). However, DMVA and DGS informed my staff that it is the policy of the Administration that OIG reports are confidential and, in accordance with Executive Order 1987-7, could not be reviewed by us. Therefore, we were unable to determine whether there were any findings in this investigation which significantly impacted our audit work and related conclusions. Furthermore, based on our review of Executive Order 1987-7, it is our opinion that DMVA and DGS officials are misinterpreting the intent of this policy in withholding the OIG report from Department of the Auditor General auditors.

This report sets out the results of our audit in detail, and an executive summary provides an overview of our findings. Instead of repeating this information here, let me focus instead on what happened--or, more accurately, what went wrong--between 1998, when DMVA decided to purchase the land in Clearfield County, and 2000, when it abandoned the project, citing political opposition and possible liability for acid-mine drainage.

First of all, we found no evidence that the site selection was the result of an open and competitive process. DMVA itself chose the site, which consisted of six tracts in Clearfield County, one of which (the Walker tract) accounted for 89 percent of the land and 75 percent of the purchase price. The Walker property was well known to the Pennsylvania Department of Environmental Protection, which had documented the existence of acid-mine drainage dating back to 1979, had issued numerous citations to the owners for excessive acid-mine drainage, and had placed the land on its list of sites in need of ongoing environmental investigation and cleanup. This information was, of course, as readily available to DMVA as it was to our auditors. Nonetheless, DMVA proceeded to execute sales agreements for the Walker property as well as for the other five tracts.

All six sales agreements provided that the Commonwealth would deposit 5 percent of the purchase price with the sellers within 45 days of the execution date, with closing to occur within 180 days of that date. Closing was contingent, however, on the Commonwealth's receiving satisfactory results from a title search and an environmental survey. That is, the Commonwealth could void an agreement at its sole discretion if it deemed either title to the property or its environmental condition unsatisfactory. Curiously, the Walker agreement was ambiguous concerning the Commonwealth's recoupment of the earnest money if these contingencies did not occur, or if the seller was otherwise in default. In contrast, the other five agreements expressly provided for the recovery of all sums paid plus interest. Other provisions in the Walker agreement that differed markedly from

those in the other five provisions, and were far more advantageous to the sellers, are enumerated in Finding #1 of our report.

Since the first payment of earnest money, amounting to $218,595, reserved the property for 180 days from the execution date of the agreements, that date took on great importance. Our review of the agreements, however, revealed either the omission of an execution date or a date that could not be substantiated. Nonetheless, DGS arbitrarily assigned a date of December 1, 1999, thus disregarding the Commonwealth Procurement Code, under which a contract is not effective until all necessary signatures are affixed. Although the 180-day period was due to expire on May 31, 2000, DGS waited until March/April to begin the title and environmental investigations. Then, on May 17, the Commonwealth invoked a contractual provision that allowed for payment of an additional 5 percent deposit (i.e., another $218,595) to extend the reserve period for another 180 days. DGS made this payment notwithstanding a title report that listed multiple impairments on the Walker property, some of which the settlement company characterized as "very serious," and notwithstanding the acid-mine drainage problem long ago identified by DEP.

Shortly before the second reserve period expired, DMVA issued its press release announcing abandonment of the project because "absolutely essential" federal funding was now in doubt. The twin culprits, according to the announcement, were "political opposition" and "outstanding concerns about potential liability for acid-mine drainage." Yet the local "political opposition" about which DMVA complained--and continues to complain--was expressed before a single sales agreement was signed and continued to be expressed thereafter. And, as previously pointed out, the acid-mine drainage problem had existed for decades. DMVA has yet to explain why it disregarded these issues until, apparently, it could disregard them no longer.

DMVA and DGS are now disregarding yet a third issue: recovery of the $326,259 in earnest money paid to the Walker parties. Notwithstanding the title impairments and the environmental damage to the land--damage which the sellers were contractually bound to disclose--the Commonwealth has steadfastly refused to bring a breach of contract action. Refusal is not based on the absence of an express recovery provision in the agreement, which management maintains would not bar recoupment. Rather, management insists that no breach has occurred. Based on our audit of the available evidence, we find management's inaction nothing short of extraordinary and continue to urge the Commonwealth to pursue recovery of public funds expended in so ill-advised a manner.

Let me emphasize that I respect, and share, DMVA's commitment to ensuring the military preparedness of our National Guard. DMVA's disappointment in the outcome of this project is, I am sure, both heartfelt and acute. I express my own regret that the Commonwealth has nothing to show for the years of effort and the hundreds of thousands of dollars it committed to acquiring so essential a facility as a tracked-vehicle maneuver training area. It is my sincere hope, therefore, that the recommendations in our audit may help ensure that future efforts and expenditures obtain a successful result.

Sincerely,

Robert P. Casey, Jr.
Auditor General

Background

In the late 1980's, the Commonwealth of Pennsylvania, Department of Military and Veterans Affairs (DMVA) began a search for a tracked-vehicle maneuver training area for the Pennsylvania National Guard. In October 1997, with the passage of Act 47 of 1997, $8,000,000 was appropriated for the acquisition of approximately 5,300 acres of land in western Pennsylvania to be used as the new training area. In July 1998, DMVA narrowed its search to several tracts of land totaling 4,700 acres in Girard and Goshen Townships in Clearfield County.

Thereafter the Department of General Services (DGS) negotiated six sales agreements for acquisition of this land at a total price of $4,371,900. The Commonwealth agreed to deposit with the sellers 5 percent of the purchase price as earnest money, giving the Commonwealth a reserve period of 180 days to complete an environmental site assessment (ESA) and title searches on the land before closing on the purchase. At closing, this earnest money was to be credited against the purchase price. DGS designated December 1, 1999--the date on which the Secretary of DGS purportedly signed the agreements--as the commencement date of the reserve period. Examination of the six sales agreements, however, substantiates that the signatures of the Secretary of DGS were undated.

Based on the December 1, 1999, commencement date, the reserve period was scheduled to expire on May 31, 2000. On March 3, 2000--the date on which, according to DGS, the last sales agreement was executed--the Commonwealth paid out earnest money in the amount of $218,595 ($4,371,900 x 5 percent) to the sellers. Also in March, three months after the reserve period began, DGS executed a $7,400 contract with a vendor to perform a Phase I ESA. A month later, in April 2000, DGS entered into a $8,500 contract with a settlement company to perform the required title searches. When it became evident that neither the ESA nor the title searches would be completed by May 31, 2000, the Commonwealth chose to make a second 5 percent earnest money payment to the sellers to extend the reserve period for another 180 days, or until November 30, 2000. Accordingly, the Commonwealth paid an additional $218,595 to the sellers on May 17, 2000, bringing total earnest money to 10 percent of the purchase price, or $437,190.

Preliminary results of the title search (i.e., a list of title impairments) were provided to DGS in May 2000. In August 2000, the Commonwealth received the results of the Phase I ESA and, on the same day, executed a second contract with the same vendor, this time for $13,200, for an additional study (Phase II ESA). The results

of the Phase II ESA were provided to the Commonwealth in October 2000.

On November 15, 2000, DMVA released a statement to the press indicating that the agreements to purchase the land in Clearfield County would be "allowed to expire without further action" due to "persistent and vocal political opposition to the project" and "outstanding concerns about potential liability for acid-mine drainage," both of which would make it difficult to obtain federal funding. Having abandoned the project, the Commonwealth allowed the sellers to retain both the $437,190 in earnest money and title to their property.

Audit Objectives, Scope and Methodology

This special audit covered the period from May 1995, when DMVA began its search for suitable land in Clearfield and Centre Counties, through November 15, 2000, when DMVA announced it was abandoning the purchase of land in Clearfield County. We began planning our audit in February 2001 and completed our fieldwork in May of that year.

The objectives of our audit were to determine:

1. Whether DGS and DMVA had adequate internal controls in place and exercised due diligence in committing public funds to the project;

2. Whether the land acquisition process used by DGS and DMVA was in compliance with applicable laws and/or regulations, and applicable Commonwealth policies and procedures; and

3. Whether the parties to the six agreements of sale were in compliance with their respective agreements.

Our audit methodology in support of these objectives consisted of the following procedures:

- Interviewing DGS officials and reviewing any Commonwealth laws/regulations and policies/procedures governing land purchases;

- Reviewing DMVA and DGS management controls over the purchase and determining if the process was reasonable and in compliance with applicable law, regulations, and policies/procedures;

- Interviewing Department of Environmental Protection (DEP) personnel and reviewing documentation, including environmental site assessments, relating to various environmental conditions associated with the land under purchase;

- Interviewing personnel of the settlement company performing the title search and reviewing results of their work;
- Reviewing documentation provided by DMVA on its site selection process and in support of the decisions made;
- Reviewing land appraisals, sales agreements, and other documents related to the purchase for reasonableness, and verifying sellers' compliance with agreement provisions; and
- Interviewing owners of property within the training area who had not negotiated agreements of sale with the Commonwealth.

Executive Summary

Following is a synopsis of the results of our audit:

- In its negotiations with the sellers for one of the sales agreements, the Commonwealth accepted provisions different from those in the other five agreements with respect to certain express rights, including the right to recoup $326,259 in earnest money. DGS failed to adequately justify management's decision to accept these provisions, which were more advantageous to the sellers than were comparable provisions in the other five sales agreements. (Finding # 1)
- We noted a total of 14 unresolved title impairments on property covered in one of the six sales agreements, which was the same agreement as above, accounting for $326,259 (or 75 percent) of the $437,190 in earnest money deposited by the Commonwealth for this land purchase. These impairments constitute a breach of contract by these sellers which should have caused the Commonwealth to pursue recovery of the $326,259 in earnest money retained by the sellers when the sale was not completed. (Finding # 2)
- With regard to the same property noted above, we also noted significant, long-term acid-mine drainage dating back to 1979. We found numerous instances in which the Department of Environmental Protection (DEP) issued environmental citations on these parcels, and listed the land as needing on-going environmental investigation and clean-up. Furthermore, DMVA's November 2000 press release stated that outstanding concerns about potential liability for acid-mine drainage were in part responsible for its decision to abandon the purchase. Like the title impairments above, the evidence we noted of acid-mine drainage constitutes a further breach of contract by these same sellers, which should have caused the Commonwealth to pursue recovery of the $326,259 in earnest money. (Finding # 2)

- We found significant weaknesses in DMVA/DGS procurement and selection procedures, which failed to ensure that the most suitable land was being purchased at the lowest or most reasonable price available. Management failed to: 1) establish an open and/or competitive procurement process; 2) explain why the purchase was not advertised to the public or opened up for competition; and 3) provide evidence to support a reasonable search and selection process or reasonably justify the procurement/selection approach actually used. We also noted major inconsistencies and other deficiencies in DMVA's documentation with regard to supporting the selection of the property in question. These deficiences raise serious questions about the decision to move forward with this purchase. (Finding # 3)

- We noted significant control weaknesses within DGS related to this purchase, including: 1) no established policies or procedures governing real estate purchases-for example, the lack of guidelines on earnest money payments; 2) mismanagement of the time period for closing on this purchase during the first 180-day reserve period, causing the unnecessary expenditure of the additional $218,595 in earnest money payments to extend the reserve period; 3) the lack of documented support for the reserve periods actually used for the purchase; and 4) failure to ensure full Commonwealth ownership of all land needed for the training area, thus calling into question the Commonwealth's right to use the land for its intended purpose. (Finding # 4)

- We noted significant control weaknesses within DMVA related to this purchase, including: 1) failure to properly and timely review readily available documentation at DEP on acid-mine drainage on the property prior to making the two nonrefundable 5 percent deposits; 2) failure to properly and timely consider local public opinion and vocal opposition regarding the purchase prior to making these earnest money payments; and 3) lack of evidence to support management's November 2000 press release stating that political opposition and acid-mine drainage would make it nearly impossible to obtain federal funding. In addition, DMVA made inconsistent and contradictory statements in response to our audit inquiries, which raise serious questions about the reasons given for abandoning the purchase in management's November 2000 press release. (Finding # 5)

Findings

Finding #1 - The Commonwealth Did Not Justify Why Provisions in One Agreement of Sale Were More Advantageous to the Sellers Than Were Comparable Provisions in Five Other Agreements

On December 1, 1999, the Commonwealth (DGS and DMVA) negotiated six agreements of sale totaling $4,371,900 to purchase land in Clearfield County for a tracked-vehicle maneuver training area for the Pennsylvania National Guard. Our review and comparison of the six agreements revealed that one of the agreements differed markedly from the other five in several respects. The agreement at issue is with Shannon

Land and Mining Company, Al Hamilton Contracting Company, and Manor Mining and Contracting Corporation, all of which are owned by the same individuals. Two key provisions of the agreement, known as the Walker agreement, are of particular note:

- Consideration - All six agreements provided for the Commonwealth to make earnest money deposits to the sellers of 5 percent of the purchase price within 45 days of the execution date of the agreements. For five of the agreements, the 5 percent deposit on the land was nonrefundable "except in the event of default of Sellers." However, in the Walker agreement, the deposit money was nonrefundable if either of the parties failed to consummate the transaction.

- Default of Sellers - The Walker agreement provided the Commonwealth with the option of rescinding the agreement upon default of the sellers, in which case "the agreement becomes null and void." The other five agreements also provided for rescission, but made explicit that the Commonwealth could then recover "all sums plus interest paid on account of the purchase price."

We made specific inquiries of DGS/DMVA officials about these two key differences. DGS stated only that each agreement was modified during the negotiation process "based on the demands of the individual sellers." For the Walker agreement, DGS stated that "the sellers would not approve an agreement that contained the concept of refundability," but that this omission "does not negate the Commonwealth's recourse to recover" the earnest money through litigation. DGS failed to explain why, in negotiating the Walker agreement, it was willing to acquiesce to the sellers' demand with regard to so basic a provision as "refundability."

We also noted a tax provision in the Walker agreement which, in contrast to the other five agreements, would have either cost state taxpayers or local taxpayers to lose approximately $32,000 in tax monies if the Commonwealth closed on the sale:

- Realty Transfer Taxes - For five of the agreements, the burden of paying local transfer taxes was placed 100 percent on the sellers because the "Buyer is exempt by law from paying real estate transfer taxes." However, the Walker agreement provided that the Commonwealth and the sellers split the realty transfer tax, with each party paying 50 percent.

In response to our inquiries, DGS indicated that it originally asked the sellers to pay the entire tax, but then agreed with the sellers' counter-offer of a 50/50 split since this "is common practice in private real estate transactions." DGS did not explain the provision in the other five sales agreements which specifically stated that the Commonwealth "is exempt by law" from paying this tax, and whether the Commonwealth's 50 percent share for the Walker agreement would have actually been paid to the appropriate local government. DGS failed to adequately explain why it agreed to this tax treatment in one sales agreement, but in none of the other five.

Furthermore, an owner of property within the boundary of the proposed training area who had not reached an agreement to sell (see Finding #4) told us that she did try to negotiate with DGS on the payment of real estate transfer taxes, but DGS would not negotiate on this point. This information raises questions about DGS's statement that variations in the Walker agreement were due solely to the "demands of the individual sellers."

Finally, we noted that two other provisions were more advantageous to sellers under the Walker agreement than under the other five agreements:

- Assignment - Five of the agreements stated that the Commonwealth could assign its rights thereunder without the prior written consent of the sellers. However, the Walker agreement specified that the agreement was not assignable by either party without the express written consent of the other party.

- Mining - Five of the agreements expressly prohibited surface extraction and provided that subsurface extraction could not take place unless the Commonwealth approved surface supports. However, the Walker agreement allowed for ongoing deep mining operations, as well as a $1.00 lease-back to the sellers for numerous ongoing surface mining areas located within the land under agreement. This provision would have allowed the former owners to continue operating their mines on Commonwealth-owned land without having to pay the Commonwealth any royalties. Based on our discussions with Commonwealth officials in the Pennsylvania Game Commission and the Department of Conservation and Natural Resources, allowing an outside party to extract minerals from Commonwealth-owned land without paying royalties is not the standard practice within the Commonwealth.

For all five provisions noted above, DGS failed to adequately explain why the sellers under the Walker agreement received more generous treatment than the other sellers. We acknowledge the possibility that, because these sellers owned approximately 89 percent of the land under purchase, and that therefore this agreement was the most critical for acquiring the proposed site, the agreement might be subject to different negotiation tactics and, as a result, contain different provisions. However, there is also the possibility that the lack of an open selection and/or competitive procurement process, as disclosed in Finding #3, put the Commonwealth at a serious disadvantage during negotiations with the Walker parties, and DGS found it necessary to alter the agreement to the sellers' advantage in order to close on the deal. Because of management's inadequate explanations and documentation, we could not determine the reason(s) for these differences.

Recommendation

DGS should maintain adequate documentation on its negotiations with property owners, especially in situations in which the Commonwealth has negotiated more advantageous provisions for one seller than for others, and Commonwealth funds are at risk. Documentation should include descriptions of key negotiating points and should

explain the reasonableness of key decisions made to reach final agreement.

Management's Response

As in all real estate acquisitions, the Commonwealth entered into the subject transactions with every expectation of completing the purchase. Regardless of the Auditor General's opinion of available documentation, several facts remain:

1. The proposed total cost of all tracts, including additional items payable at closing, was more than $3,000,000 below the amount approved by the legislature for this purpose and approximated the total appraised value of the properties. In addition, timber valued between $90,000 and $200,000 would have been acquired through the transaction, further improving the economics. Therefore, the Commonwealth was benefiting from successful negotiation.

2. The Walker - Hamilton - Lingle tract constituted 89 percent of the land to be acquired. Accordingly, final terms of the purchase agreement would reasonably be expected to differ from the others.

3. No payment for royalties was appropriate in this transaction, since the Commonwealth was not purchasing mineral rights. If such rights had been acquired, the cost of the property would have been significantly higher.

4. In private real estate transactions, option payments simply reserve rights for the buyer and compensate the seller for removing property from the marketplace. Ordinarily, no credit is given toward the sale price at settlement. However, by agreement, advance amounts paid for the Walker - Hamilton - Lingle tract would have been applied against the purchase price. As in private transactions, the seller was protected against the possibility that the buyer would not complete the sale.

5. Without the aggressive political opposition that ultimately led to the transaction's demise, the Commonwealth would have acquired land needed for a Pennsylvania National Guard training facility at market price. The differences among the sales agreements would have had absolutely no impact.

Nevertheless, the Department of General Services will review acquisition processes and documentation in order to identify and implement appropriate improvements.

Auditors' Conclusions

First, we commend DGS for agreeing that a review of its procedures for acquiring property is warranted. We note,

however, that management failed to address the particulars of this finding as follows:

1. Management's points about purchase price and timber acquisition have no bearing on the questionable provisions we identified in the Walker agreement, provisions that management has not even attempted to justify. Management simply characterizes as "successful" negotiations that resulted in the expenditure of over $400,000 in public funds and the acquisition of nothing in return.

2. Management has done little more than reiterate what we ourselves acknowledged in the finding, namely, that the size of the Walker tract (referred to by management as the Walker - Hamilton - Lingle tract) may have influenced negotiation tactics. We also stated that the more generous provisions in the Walker agreement may have resulted from the absence of an open selection or competitive procurement process. We pointed out, though, that we could not determine why these special provisions were agreed to inasmuch as management had provided no adequate explanations or documentation. Management now "explains" merely that the terms of the Walker agreement "would reasonably be expected to differ from the others." We still do not know why management made the unique, and ultimately costly, concessions identified in the finding. Given the fact that the Walker property made up 89 percent of the land in this transaction, it would seem prudent for the Commonwealth to have protected itself against exposure to a major loss by negotiating terms which would have been as favorable as those in the other five agreements.

3. With regard to royalties, management's statement that "the Commonwealth was not purchasing mineral rights" is incorrect. In one of the six agreements (Salvatore), the Commonwealth purchased "…all of Seller's rights in the coal, minerals, gas and timber located on or underlying the said tract of land…." The land was to be purchased for $850,000, which was $372,000 (or 30 percent) less than the appraised value of $1.22 million. This transaction casts doubt on management's assertion that acquiring mineral rights would have significantly raised the purchase price.

   Management's claim that "[no] payment for royalties was appropriate in this transaction" is also questionable. Our further review of the mining provisions in the six sales agreements, along with additional discussions with an official in the Pennsylvania Game Commission, resulted in the following observations. The Walker agreement expressly provided for the sellers' rights of "ingress, egress, and regress" so as to continue deep mining on the property after its sale to the Commonwealth. The other agreements, except for the Salvatore agreement, expressly allowed the sellers to retain their mineral rights, but none of these agreements gave the sellers the rights of ingress, egress, and regress. According to Game Commission officials, when an agreement gives the seller express rights of access to the land, the common practice is for the Commonwealth to negotiate for the collection of royalties on extracted minerals in exchange for such access. Management has offered no explanation for why it deviated from common practice in the Commonwealth or why this mining provision in the Walker agreement was significantly more advantageous

to the sellers than the provisions in the other agreements. Management has not, in fact, revealed whether royalties were even considered during negotiations with the Walker parties.

4. In the draft of this report submitted for management's response, we used the term "option payments" to refer to the amounts paid to the sellers--ultimately 10 percent of the purchase price--to ensure that the land would remain available for purchase while the Commonwealth conducted title searches and environmental investigations. Since management preferred the term "earnest money," we made that change throughout our report. Whatever term we use to refer to this money, however, the fact remains that its recoupment upon default by the seller was clear in five of the agreements and ambiguous in the Walker agreement. Moreover, management's expressed concern for protecting the seller against the buyer's failure to complete the transaction is fine as far as it goes, but should have been counterbalanced by concern for protecting the Commonwealth against the seller's default.

5. Management's statement that "(t)he differences among the sales agreements would have had absolutely no impact" is unsupported and unsupportable. Had the sale been consummated, there would have been distinct differences in payment of real estate taxes, continuation of mining operations, and assignment of rights. Yet again, management chooses to provide no explanation for significant contractual differences with regard to consideration and default of the seller. Management's claim of "aggressive political opposition" as the only cause of the transaction's demise is irrelevant to this finding. We address this claim, however, in connection with management's responses to Finding #5 and to the audit report in general.

Our finding and recommendation, with the above clarifications, remain as stated.

Finding #2 - The Commonwealth Should Pursue Recovery of $326,259 in Lost Earnest Money Due to Breach of Contract by the Sellers

In accordance with the six agreements of sale for a tracked-vehicle maneuver training area, the Commonwealth paid the property owners 10 percent of the purchase price, or $437,190, in the form of earnest money that gave the Commonwealth one year to finalize the purchase or allow its purchase option to expire. All six sales agreements provide, in part: "The title is to be good and marketable and such as will be insured by any responsible title insurance company, licensed to do business in Pennsylvania…." To verify good title, DGS contracted with a settlement company to perform a title search on the properties under agreement.

The Walker agreement (see Finding #1) accounted for $3,262,590 (or 75 percent) of the total purchase price, and these sellers received $326,259 (or 75 percent) of the $437,190 in earnest money. Based on our review of the results of the title search and discussions with settlement company officials, we noted significant title impairments

associated with the property included in this sales agreement, which constitute a breach of contract by the sellers. (Note: No title concerns were identified for the other five sales agreements.)

In particular, the settlement company initially identified title concerns with 41 of the 48 parcels of property included under this particular agreement. In a letter to DGS, the settlement company stated, "As you will see from the parcel breakdowns included, there are many issues, some very serious, that would have to be dealt with before the insurance company would even consider insuring the titles. It is possible that even after hours of examination, they may elect not to insure the titles anyway."

In response to our inquiries about these title impairments, DGS provided documentation to support their follow-up on 27 of the 41 title concerns raised by the settlement company. DGS also commented that it was satisfied that all significant title impairments had either been corrected, or management "would have negotiated terms" with the sellers on any remaining issues at settlement. However, based on our review of the documentation provided, 14 of the 41 impairments were not addressed by DGS or the sellers. There is no evidence to demonstrate that these impairments could have been corrected and clear title conveyed at settlement, or that "negotiated terms" would have enabled the sellers to deliver clear title. Following are some examples of these unresolved title impairments:

- There were problems with estates, including unpaid inheritance tax and division of property between heirs;
- There were no recorded deeds for previous owners;
- Previous owners died intestate and no estate was filed in Clearfield County;
- Previous owners never signed and certified property deeds;
- There were discrepancies between assessment records and deeds as to the identity of property owners and the percent of ownership of certain parcels;
- Current assessment cards filed in Clearfield County stated that several parcels were owned by Shannon Land and Mining Co., but nothing of record was found to show how Shannon acquired the parcels.

Our discussions with a representative from the settlement company disclosed that upon sending notification of these impairments to DGS the settlement company was told to hold off on working further with this project. The company's last contact with DGS was in July 2000. The representative from the settlement company indicated that he was never instructed to apply for title insurance or begin preparations for settlement.

In our opinion, the title impairments are sufficiently significant as to preclude the sellers from delivering

marketable title, as required by section (9) of this agreement of sale. Accordingly, we believe there was a breach of contract by these sellers. Other related provisions of this agreement are as follows:

(3) Contingencies

A. Buyer will perform a title search on the premises. If title . . . is unsatisfactory to Buyer, Buyer may, in its sole discretion, void this agreement.

(6) Default of Sellers. In the event that title to the Premises cannot be conveyed by Sellers to Buyer at settlement in accordance with the requirements of this Agreement of Sale . . . or Sellers are otherwise in default in the performance of the provisions hereof, Buyer may . . . (b) rescind this Agreement.

We also noted in our audit that the six sales agreements included provisions on environmental matters. In particular, section (9) of the sales agreements (section (10) of the Walker agreement) contained the following environmental provisions and seller warranties:

At its option and sole expense, Buyer shall contract for an environmental site assessment within ninety (90) days of the "Execution Date" of this agreement…. Should the Buyer deem the results of the assessment to be unsatisfactory, Buyer may, at its sole discretion, either (a) accept the Premises "as is," or (b) declare this agreement null and void.

* * *

Seller warrants, to the best of its knowledge,…that the Premises is not listed or proposed for listing on…any state list of sites requiring environmental investigation or cleanup.

* * *

Seller agrees to provide, if any, environmental inspections, investigations, studies, audits, tests, reviews, or other analyses that have been conducted on the Premises.

As pointed out in Finding #5, our review of DEP's files disclosed significant documentation concerning the existence of acid-mine drainage dating back to 1979 on the properties to be purchased. Furthermore, we noted numerous instances in which DEP issued citations for excessive acid-mine drainage on parcels in the Walker agreement, and included this same land on its state list of sites requiring ongoing environmental investigation and clean-up. The Commonwealth also had concerns about potential liability for acid-mine drainage, as disclosed in DMVA's November 2000 press release. We noted that, despite all the environmental investigations, inspections,

tests, citations, etc., on the properties in the Walker agreement, the sellers provided no information to DMVA/DGS in compliance with the environmental matters section of the sales agreement.

We asked Commonwealth management about the possibility of breach of contract by the sellers concerning the environmental clauses. Despite management's comment about "environmental concerns" in its November 2000 press release canceling the agreement, DGS claimed that "(t)he Commonwealth did not declare the agreement null and void because the property was still fit for the intended use. Remedial work could have been performed by DMVA with its own forces." No further explanation was given as to what or the amount of remedial work would have been necessary, or why recovery of the earnest money was not pursued due to environmental concerns and the "null and void" clause in the agreement. Regarding the seller warranty about a state list of sites requiring environmental investigation/cleanup, DGS claimed that management did not know whether the sellers under the Walker agreement knew that their properties were on a state list. Given the ongoing investigations, multiple citations, and extensive documentation in DEP's files from regular site visits to the Walker properties, we do not consider this response an acceptable reason for not pursuing recovery of the earnest money for breach of contract.

The Commonwealth's express right to void the sales agreements for environmental problems would appear to constitute sufficient reason for pursuing recovery of the earnest money paid out and retained by the sellers. Furthermore, like the title impairments previously noted, we believe the sellers under the Walker agreement violated the environmental clauses of this agreement, and this would constitute a breach of contract by these sellers.

As explained in Finding #1, five of the six agreements provide that if the seller cannot deliver good title or is otherwise in default, the Commonwealth can "recover all sums plus interest paid on account of the Purchase Price." The Walker agreement, in contrast, provides that if the seller cannot deliver title or otherwise defaults, "both parties shall be released from further liability or obligation hereunder, and this agreement shall become null and void and the foregoing shall be the Buyer's sole remedy and any other remedies by contract or at law or in equity are prohibited." No mention is made of recovering the earnest money.

However, DGS has maintained that the contractual language unique to the Walker agreement (i.e., the language pertaining to default by the sellers) was not intended as, nor would it be, an impediment to recouping the earnest money if default had indeed occurred. Although the language may in fact turn out to be problematic in that there are internal inconsistencies in the agreement and marked differences from the language in the other five agreements (see Finding #1), the Commonwealth should make whatever arguments are available to it in support of recovering all earnest monies paid to the defaulting sellers.

Recommendations

We recommend that the Commonwealth pursue recovery of the $326,259 in earnest money paid to the sellers under the Walker agreement. Recovery should be based on the Commonwealth's rights stemming from the multiple instances of breach of contract by these sellers.

We also recommend that, when negotiating future land purchase agreements, the Commonwealth should insist on express contractual language like that found in the other five agreements - that is, language clearly delineating its right to recover all deposits in the event that sellers are unable to deliver marketable title.

Management's Response

The Department of General Services agrees that language in future contracts should address the issue of deposit refundability, if the seller is unable to deliver marketable title to property being purchased. However, prior to invoking penalties under such a clause, the Commonwealth must offer the seller reasonable time and opportunity to resolve outstanding clouds on the title. Only the seller's inability to deliver marketable title at the scheduled time of settlement would constitute breach and, therefore, trigger refund of any advance payment. In this case, the transaction never progressed to settlement. Our experience has shown that title clouds such as these are resolvable. The Auditor General's suggestions to the contrary are not based on the realities of real estate transaction.

Regardless of the Auditor General's comments regarding environmental conditions of the proposed site, the Departments jointly contracted for environmental assessment studies in preparation for the purchase. Obviously, since Military and Veterans Affairs had originally specified their desire to obtain reclaimed mining land which would not be harmed by their intended use, that agency was aware of the possibility of acid mine drainage and other related problems.

In the Phase I report prepared by Gannett Fleming, a national engineering firm with local expertise, the assessment "identified two locations of existing petroleum product storage and identified storage containers." No hazardous material storage or releases of petroleum production or hazardous materials were identified, and the executive summary calls the known storage a "de minimis situation related to property maintenance."

"...No direct evidence of historic releases was observed during site reconnaissance; however, it cannot be ruled out that residual petroleum products are present in association with former mine areas," according to the assessment. Consequently, the firm recommended a Phase II investigation "to evaluate the presence of hazardous materials or petroleum products that might be emanating from or present within the site, but would be otherwise undetectable under the scope of a Phase I site assessment."

The study was undertaken as suggested. On October 12, 2000, Gannett Fleming concluded, "Based on the results

of the stream sampling program, no additional studies are recommended to locate historic petroleum product releases, as there is no indication that such materials are present or are migrating in the water discharging from the Study Area. Acid mine drainage is present in Surveyor Run and Deer Creek, and is a long-term problem that is unlikely to be significantly attenuated by natural means within the foreseeable future. The sources of this acid mine drainage are abandoned mine lands. The proposed DMVA land uses for the site will not contribute to any worsening of the situation, and significant water quality improvements could in fact be realized through beneficial environmental management practices . . . it is recommended that avenues be studied to incorporate acid mine drainage abatement practices into National Guard training activities. Acid mine drainage abatement is largely a function of treating existing mine drainage discharges and sealing avenues of surface water migration to contact with acid-producing spoils or abandoned underground mine voids. These functions could be fulfilled by Guard earthmoving equipment and ground personnel as part of regular training in equipment operation and facility construction."

The innuendos of those politically opposed to the project have no merit and in fact are entirely unsupported by the results of professional engineers.

Auditors' Conclusions

We commend DGS for concurring with our recommendation that future contracts for the acquisition of property expressly require a seller, who cannot deliver marketable title, to refund deposits made by the Commonwealth. Management's insistence that marketable title to the Walker tract would have become an issue only at settlement, however, isolates part of one contractual provision cited in our finding and ignores two other provisions. Paragraph (6) of the agreement does indeed address the sellers' failure to convey good title at settlement. But paragraph (3)(A) gives the buyer the right, "at its sole discretion," to void the agreement if the buyer, after performing a title search, regards title as unsatisfactory--that is, not "good and marketable and such as will be insured by any responsible title insurance company" (see paragraph (9)). Rescission is also available to the buyer under paragraph (6) if the seller "default[s] in the performance of [any] of the provisions [of the agreement]."

As set out in the finding, neither DGS nor the sellers addressed 14 of 41 title impairments identified by the settlement company in a preliminary report dated April 26, 2000. The settlement company observed that "there are many issues, some very serious, that would have to be dealt with before the insurance company would even consider insuring the titles. It is possible that even after hours of examination, they may elect not to insure the titles anyway…. [I]t was the opinion of the insurance company that they fully expected to find equal to, or greater problems in the remaining chains of titles once completely looked at."

Management's confidence that the "outstanding clouds on the title" were "resolvable" is unrealistically optimistic in view of the nature of these "clouds"--for example, the absence of recorded deeds for previous owners. Based on

the unsatisfactory results of the title search, DGS had every right--if not every duty--to void the agreement and take whatever action was available under it to recoup the earnest money. Instead, management forged ahead with the purchase, making a second deposit of earnest money to extend the reserve period for another 180 days. Inasmuch as environmental information from DEP should have dissuaded DGS from undertaking this purchase on behalf of DMVA in the first place, one might characterize this second payment as throwing good money after bad.

In its November 15, 2000, press release, DMVA gave two reasons for abandoning the purchase: political opposition and concerns about possible liability for acid-mine drainage. In its zeal to defend itself against any suggestion that the sellers breached the environmental clauses of the agreement, management attempts now to disavow its own words, relying on lengthy excerpts from the Phase I and II ESAs to show that there were no environmental concerns, notwithstanding the presence of acid-mine drainage. Management chose simply to disregard the facts we presented concerning DEP's issuance of multiple citations for excessive acid-mine drainage on the Walker property and its placement of the land on its state list of sites requiring ongoing environmental investigation and cleanup.

The environmental clauses in the Walker agreement (Section 10) required the sellers to, among other things, disclose inspections, investigations, etc., conducted on the premises and to warrant that the premises were not on any state list of environmentally compromised sites. To its credit, management does not in its response assert that the sellers were unaware of DEP's ongoing activities in connection with their property. Nor, however, does management offer any explanation for why it did not exercise its right to declare the agreement null and void "at its sole discretion," and take steps to recoup its earnest money, based on the sellers' breach of its environmental disclosure and warranty obligations.

As a result, our finding and recommendation that the Commonwealth pursue recovery of the $326,259 in earnest money remain as stated.

Finding #3 - Weaknesses Existed in the Procurement and Selection Process Used by the Department of Military and Veterans Affairs and Department of General Services

As part of our audit, we asked DMVA and DGS officials to explain what type of procurement process was used to obtain the most suitable land at the lowest or most reasonable price available before committing public funds to the purchase.

We found that neither DMVA nor DGS established an open or competitive process. In response to our inquiries, neither agency explained why the land purchase was not advertised to the public or opened up for competitive procurement, nor did they mention any prior experience or precedent as support for their approach. DMVA

indicated that it was the responsibility of DGS to assist in the search by contacting "local industrial development corporations, county commissioners, local and state-wide real estate brokers, legislators, and the local elected officials to determine if they are aware of any sites that may be available. The contacts vary depending upon characteristics . . .." However, DMVA/DGS provided no evidence that any of these contacts were actually made as part of the search process.

We also learned that in mid-1997, DMVA located land considered suitable for this purchase near Houtzdale in both Centre and Clearfield Counties (collectively known as the "Powell property"). A colonel in the National Guard, after a two-day reconnaissance of this land accompanied by a surveyor and a geologist, drew up a detailed memo in June 1997 which described this land as meeting or exceeding all the requirements of the National Guard, including no significant environmental cleanup concerns, no significant water obstacles, and no nearby neighbors. In 1996 and 1997, the Adjutant General and other Commonwealth officials visited this property at least four times and were seriously considering it for purchase.

In addition, DMVA provided us with a copy of the "Request for Project Action" dated October 27, 1997, that was signed by the Governor. This document served as official approval to purchase a tract of land in accordance with Act 47. Section 8 of the document stated, "The location of the property is more Western Central Pennsylvania than Western Pennsylvania. Travel from Erie is approximately 150 miles, from Pittsburgh approximately 100 miles, and Washington is approximately 125 miles." This exact language was used in the National Guard memo of June 1997 describing the Powell property. Furthermore, Section 12 of the "Request" form described the site as being located in "Clearfield and Centre Counties," which also matches the Powell property, not the Walker property, which is located in Clearfield County only. It appears, then, that in October 1997, DMVA intended to purchase the Powell property, not the Walker property actually purchased in 1999.

On May 29, 1998, nearly a year after the June 1997 memo on the acceptability of the Powell property, another National Guard memo compared the Powell property to the Walker land ultimately selected for purchase. This site-to-site comparison, which was the only document provided to support DMVA's rejection of the Powell property and selection of the Walker property, contradicted in significant respects the description of the Powell property in the June 1997 memo. For every contradiction, the 1998 site-to-site comparison characterized the Powell property as a less desirable site than did the 1997 memo. The notable differences in these properties were in the following DMVA rating categories:

- Number of platoon lanes
- Number of stream crossings/fords
- Existence of a native trout stream

- Environmental damage
- Existing water and electric utilities and other improvements

When asked about these differences, DMVA officials failed to offer any explanations. We also found that DMVA had visited the Powell property four times up through July 19, 1997, but did not inspect the land after that date, which was 10½ months prior to the May 1998 site-to-site comparison.

We also noted major discrepancies in the 1998 site-to-site comparison, which described the Walker property in more favorable terms than was actually the case. For instance, concerning environmental liability, the Walker property was described as having "(n)o known problems," a characterization that we found to be clearly incorrect (see Finding #'s 2 and 5), especially since acid-mine drainage was a major reason for DMVA's abandoning the purchase of this property. Concerning suitability for maneuver, the Walker property is listed as having no stream crossings, whereas a map shows there are five distinct streams within this site that significantly segment the property. Also, DMVA's basic requirements for the land included no neighbors nearby; there are, however, numerous residences near or within the boundary of the Walker property.

In addition to not explaining the significant discrepancies noted above in the site-to-site comparison, DMVA officials also failed to explain: 1) how they arrived at estimated costs for land improvements on the two properties; 2) on what basis they rated the properties as "fair," "good," or "excellent" under different categories; 3) why the comparison did not include estimated acquisition cost, which was the largest cost item, as a factor in the analysis; and 4) their overall analysis and decision-making process in selecting the Walker property over the Powell property.

Despite our many audit inquiries, DMVA provided no documentation to support any of the information in the 1998 memo, nearly all of which favored selection of the Walker property over the Powell property.

When we asked about documentation to support other sites that were investigated for purchase, DMVA provided only one document: a copy of a two-page memo dated March 12, 1997, from the Pennsylvania National Guard to DMVA, which listed a few sites that had been visited. However, there was no documentation confirming that these visits were in fact made. The memo explained that these sites were rejected because of conditions such as "a good deal of active mining and unreclaimed land involved" and "partially reclaimed strip mine land" with "serious environmental problems." As explained in Finding #s 2 and 5, we noted similar environmental problems on the Walker land which ultimately contributed to abandonment of this purchase.

The March 1997 memo also reiterated basic requirements for land to be considered for purchase, including "prefer mining land reclaimed to EPA industrial standards - cannot consider land with any significant cleanup involved"

and suggested "no significant streams…or other environmental and trafficability limitations." In addition, this memo stated that there should be "no near neighbors" on the land. DMVA officials provided minimal information and no documentation to explain the significant discrepancies between their rejection of sites due to environmental problems and their later decision in 1999 to purchase the Walker property with similar environmental damage.

We also noted that the March 1997 memo included a reference to "the 5300 acre parcel in Clearfield County," which "is the only tract so far which meets our needs." We asked DMVA officials whether the tract referred to was the Powell or the Walker property. They responded that it was the Walker property. As a result, we noted that the March 1997 memo-representing the only document supporting the investigation of other sites for purchase-makes no reference to the Powell property, which was well known to DMVA officials in 1996 as an acceptable site for purchase. The reference to the Walker land as "the only tract so far which meets our needs" is clearly an inaccurate statement based on the evidence obtained in our audit.

Based on the disclosures above, the decision to purchase the Walker property was not adequately supported by DMVA. Also, there were significant weaknesses in the selection and procurement process for this purchase at both DMVA and DGS. Owing to these weaknesses, DMVA and DGS did not ensure that the most suitable land was being purchased at the lowest or most reasonable price available. The lack of a competitive procurement process may have placed the

Commonwealth at a competitive disadvantage in their negotiations for the Walker property (see Finding # 1) and may have caused the inappropriate payment of $437,190 in earnest money lost when the purchase was later abandoned.

Recommendations

We recommend that both DMVA and DGS ensure that reasonable, open competition exists in the purchase of real estate to ensure that the Commonwealth is receiving the most suitable land at the lowest or most reasonable price on future land purchases. Furthermore, management should ensure that purchase decisions are adequately supported, reviewed, and approved before committing public funds to acquiring land.

Management's Response

The role of the Department of Military and Veterans Affairs, as the customer in this transaction, was to determine necessary attributes for a tracked-vehicle training area and to identify available land in an appropriate location. After a decade-long search, the Pennsylvania National Guard identified a site consisting of seven tracts of land in Clearfield County as meeting their needs.

In its role as real estate agent, the Department of General Services utilizes state-licensed appraisers and other market analyses to ensure that a reasonable price is negotiated for selected land. As stated in the response to the Finding #1 Recommendation, in this case the proposed cost approximated the appraised value.

Both departments supported and approved the purchase decisions, as made, until unanticipated political opposition rendered project completion impossible.

Nevertheless, Military and Veterans Affairs and General Services will continue to review acquisition processes and documentation to identify opportunities for improvement.

Auditors' Conclusion

Management's general remarks are not responsive to the details in our finding. The finding speaks for itself, and further comment on our part is unnecessary. Therefore, our recommendations remain as stated.

Finding #4 - Control Weaknesses in the Department of General Services Caused or Contributed to the Unnecessary Expenditure of $437,190 in Public Funds

Our audit revealed that DGS has no standardized policies or procedures in place governing real estate purchases in general, or the payment of earnest money in particular. In response to our inquiries, DGS personnel referred us to Act 45 of 1975[1] as the only state law or regulation addressing the purchase of real estate. Although this act gave DGS the power to purchase real property, it did not establish any specific guidelines, policies, or procedures for DGS to follow. In their absence, management does not have adequate controls in place to ensure that real estate purchases are made consistently and in the best interests of the Commonwealth. The need for established guidelines was especially critical for the purchase under audit, in which the Commonwealth was about to acquire land with a long history of significant mining operations and environmental problems.

In response to our inquiry on the authorization to pay out the earnest money for this transaction, DGS officials made a vague statement that "under Act 45 of 1975, the Department negotiates real estate transactions similar to the process used by the private sector," with no further explanation. However, our review of Act 45 disclosed that there was no mention of private sector standards or procedures in its provisions; thus, these payments appear to be based on management's decision. DGS officials also explained vaguely that the earnest money paid out in this transaction was due to "the results of negotiation." Given the inadequate explanations provided by management, and given the history of this purchase and its ultimate outcome (i.e., abandonment), DGS's attempt to use private sector standards proved to be decidedly unwise.

To review the reasonableness of the earnest money deposited with the sellers for this proposed purchase, we inquired about deposits used in other real estate purchases by DGS. DGS provided a listing of all its real estate purchases going back to 1995. Out of the 23 purchases on this list totaling $22.3 million, only four purchases included down payments totaling $1,066,000, or 4.78 percent of the total purchase dollars. This is less than one-half of the 10 percent in deposits made for the land purchase under audit. Furthermore, one transaction on the listing for $16.9 million (or 76 percent of the total purchase dollars) and with $1 million in down payments (or 94 percent of the total), called for an initial down payment of only $50,000 (or 3/10 of 1 percent). The remaining $950,000 was to be paid only after the Commonwealth completed its property inspections, records reviews, title searches, etc., for the property in question (building). This was not the case for the land purchase under audit in which all the earnest money was deposited with the sellers before completion of these necessary procedures to close on the purchase.

Furthermore, we reviewed correspondence relating to the use of earnest money deposits from purchasing agents in seven other states to confirm the reasonableness of the deposits used in this transaction. In six of these seven states, purchasing agents did not use earnest money deposits in their purchase of real estate like the earnest money in the transaction under audit. The one state that used earnest money payments frequently secured purchase options for one dollar, and the deposits rarely exceeded one percent of the purchase price. Based on our review of other Commonwealth purchases and our review of correspondence from other states on their purchase practices, the use of a deposit arrangement in which 10 percent of the purchase price (along with the land itself) can be retained by a non-defaulting, much less a defaulting, seller if the deal is not closed, appears highly unusual, if not unprecedented.

DGS treated December 1, 1999, as the date from which the reserve periods began to run on all six sales agreements, initially telling us that this was the date on which all six agreements were executed. However, examination of the agreements and later statements by DGS officials contradicted this initial assertion. In fact, as DGS conceded, three of the agreements were not signed by sellers until January 21, 2000, with the last agreement not being signed until March 2, 2000. When confronted with this discrepancy, DGS officials then explained that to avoid confusion they fixed December 1, 1999, as the execution date based on the premise that the Secretary of DGS signed all six agreements on this date. This assertion also fails to withstand scrutiny as the Secretary failed to date any of his signatures and the agreements themselves either bore execution dates other than December 1, 1999, or no execution dates at all.

Although it allowed the reserve period to begin to run from December 1, 1999, DGS did not start to undertake the environmental site assessment (ESA) and the title search until March and April 2000, after the last agreement was actually signed by the seller. When we asked why the ESA and the title search were delayed for three to four months into the first reserve period, DGS replied that contract "documents were lost during the signature process." Thus, DGS placed itself in the untenable situation of having to complete the ESA and the title search in

less than 90 days and was thereby forced to extend the reserve period to November 30, 2000, at substantial additional cost to the Commonwealth.

By November 15, 2000, when DMVA announced its intention to abandon the purchase, DGS still had not negotiated agreements of sale with two landowners within the boundaries of the proposed tracked-vehicle maneuver training area. A map of the area shows that, without these two properties, the proposed training site was significantly segmented, and travel through the property would clearly have been hindered. In response to our inquiries, management did not explain why it committed the Commonwealth to the purchase without these two properties being included in the sales agreements. Although DGS maintained that agreements would have been executed with both of these landowners, no agreements existed as of November 15, 2000, or almost a year after the designated execution date for the six sales agreements in late 1999.

Our review of documentation also disclosed that one of the properties included in the purchase, a 695-acre parcel, was only 50 percent owned by the Walker parties, who held the land as a tenancy-in-common and negotiated to sell their 50 percent share to the Commonwealth. In response to our concerns about the Commonwealth's rights of use for this property with only 50 percent ownership, DGS stated that "by definition, each owner has an undivided interest in the property, and each is entitled to equal use and possession." DGS further stated that "50 percent ownership rights would have supported" the Commonwealth's "intended use of this property as a bivouac site." However, DGS did not provide any documentation to support the ownership rights of the sellers or the ownership rights of the Commonwealth as purchaser of this parcel. Therefore, DGS could not demonstrate the appropriateness of including this 695-acre parcel in the Walker sales agreement, along with the related earnest money paid on the parcel, with only 50 percent ownership of this parcel.

Recommendations

We recommend that DGS establish formal, written policies and procedures to govern the purchase of real estate. These procedures should include guidelines on the use of earnest money deposits, their percents/amounts, and the proper documenting and management of reserve periods to avoid unnecessary costs. DGS should also consider researching any earnest money policies of other governmental entities to better ensure that the Commonwealth's procedures are reasonable.

In addition, we recommend that DGS strengthen controls over future real estate purchases by: 1) obtaining more evidence that appraisals and negotiated prices are the most reasonable; and 2) ensuring that all property owners are identified and the needed properties are covered by sales agreements before committing public funds to the project.

Management's Response

The Department of General Services agrees that formal policies and procedures should be established as a framework for real estate procurement transactions. Such guidelines, including the subject of advance payments, will be developed using available resources within the Commonwealth and outside it.

Regardless of the need for policies and procedures, the Department takes exception to the Auditor General's conclusions regarding "options." The Commonwealth did not utilize traditional "options" to reserve these properties. Instead, earnest money, which would have been applied against the purchase price, was paid to each seller. Under the terms of the sales agreement, any decision by the buyer not to complete the transaction within the agreed time period would result in the forfeiture of the earnest money.

Since the Commonwealth's standard agreement (copy provided to auditors) states that the Secretary of General Services' signature will establish the document execution date, the date of the seller's signature does not establish the beginning of the reserve period. Regardless, contrary to the Auditor General's report, all sellers had signed their respective agreements prior to the December 1 signature of the Secretary (see Attachment to Management's Response), which signaled commencement of the reserve period.

Although the Department would agree that all property owners should be identified prior to initiating a purchase, not having done so did not impact the outcome of this undertaking. If the transaction had continued to settlement, General Services would have concluded negotiations for all remaining property; otherwise, the National Guard training activities would have avoided areas not acquired.

In either event, execution of sales agreements is a commitment of public funds.

Auditors' Conclusions

We wholeheartedly support DGS's decision to formalize policies, procedures, and guidelines as a framework for acquiring real estate. Regarding the remainder of management's response, our conclusions are as follows:

As we explained in our auditors' conclusions to Finding #1, we changed "option payments" in our draft report to "earnest money" in this final report. We note, however, that we used "option payments" throughout our correspondence with DGS during our audit, with no objection being raised. Furthermore, based on our review of industry definitions of both terms, it appears that the transaction in question had elements of both option payments and earnest money. In any event, these semantic distinctions have no bearing on our report or our conclusions.

Management's response does not clear up the confusion surrounding the execution dates of the sales agreements. In April 2000, a staff person in DGS's Bureau of Professional Selections and Administrative Services told us that

five of the six agreements had been executed on January 21, 2000, and that execution of the sixth agreement did not occur until March 2, 2000. Hence the first 5 percent deposits with the sellers were not made until March 3, 2000.

The copies of the sales agreements we were given during our audit are fully executed--that is, they contain all the necessary signatures--but only three bear an execution date of January 21, 2000. A fourth agreement shows November 1, 1999, as the execution date, and the remaining two agreements show no date. Curiously, the copies attached to management's response are not fully executed and are either left blank as to the execution date or show a date that does not match the date on the fully executed agreements we received during our fieldwork. Furthermore, as pointed out in our finding, on none of the agreements did the Secretary of DGS date his signature--an inexplicable omission since the agreements arbitrarily established the date of the Secretary's signature as the execution date[2]. More important, establishing an execution/effective date in this manner runs afoul of section 543(a) of the Commonwealth Procurement Code, 62 Pa.C.S.A. § 543(a), which provides that *[i]rrespective of the type of contract, no contract shall be effective until executed by all necessary Commonwealth officials as provided by law*[3].

Thus, irrespective of when the Secretary signed, the agreements were not effective until all other necessary signatures were obtained. Management's response casts no light on our finding that the execution dates for these agreements were never clearly established and that the 180-day reserve period was never properly validated.

No new information was provided in DGS's response which would mitigate any of the other weaknesses disclosed in the finding. Therefore, our finding and recommendations remain as stated.

Finding #5 - Control Weaknesses in the Department of Military and Veterans Affairs Caused or Contributed to the Unnecessary Expenditure of $437,190 in Public Funds

In its press release dated November 15, 2000, DMVA gave the following reasons for abandoning the purchase:

First is the persistent and vocal political opposition to the project. While we continue to believe that most people in Clearfield County would welcome the Guard and the positive economic benefits of this project, it has become clear that a small but vocal group of opponents would argue vigorously against the project to the federal government. Our experience has been that their opposition would make the difficult job of obtaining federal funding nearly impossible. The second factor is our environmental concerns. Although the preliminary environmental assessment on the site proved generally positive, there are outstanding concerns about potential liability for acid-mine drainage.

Because of those two factors, we have determined that the Clearfield County project is not likely to win federal funding, and that we cannot justify the risk to taxpayers of further pursuing the purchase of this property.

Regarding the acid-mine drainage problem, we asked DMVA management whether they had reviewed available DEP files and spoken with DEP officials to ascertain the environmental condition of the land prior to committing funds for its purchase. DMVA responded only that its "cursory examination revealed no significant environmental issues" in DEP's files. After our request for more detail about this examination, DMVA officials stated that they interviewed local landowners and managers, and reviewed mining, water sampling, and permit documentation on file at both DEP and a local coal company. When we asked for documentation to support when or if any of these activities took place, DMVA referred us to results of the Phase I ESA performed by the contracted vendor during the first 180-day reserve period and communicated to DMVA in April 2000. No documents were provided to demonstrate that DMVA performed, or contracted to perform, any environmental research prior to executing the sales agreements in late 1999.

However, when we visited DEP's local district office at Hawk Run in Clearfield County, we found significant documentation in DEP's files concerning the existence of long-term acid-mine drainage dating back to 1979 on the properties to be purchased. DEP officials informed us that the acid-mine drainage from several decades of mining in the area was well documented and has caused the death of virtually all aquatic life in two streams within the boundaries of the land proposed for purchase.

Therefore, extensive information and documentation showing acid-mine drainage on the land in question was readily available at the local DEP office. But DMVA could provide no evidence that they inquired about or examined this documentation before committing funds to the purchase. Despite this relevant information available at DEP, DMVA appeared to place total reliance on the outside vendor performing the ESA after the sales agreements were executed.

We also reviewed the results of the Phase I ESA, dated April 2000. This ESA draft report contained numerous statements showing the existence of acid-mine drainage, including documented interviews with DEP employees stating that "DEP has extensive water quality data for the study area." The report also stated that "mining activities within the study area have had a significant impact on surface and ground water quality through the formation of acid-mine drainage" and included several pictures of discolored bodies of water (commonly referred to as "yellowboy") caused by acid-mine drainage. This information was reported to DMVA prior to May 2000, when the second earnest money deposits were made.

DMVA officials appeared to underestimate the importance of the acid-mine drainage information presented in the draft report and told us that the Phase I ESA results "proved generally positive." As a result, the Commonwealth signed a second contract totaling $13,200 for a Phase II ESA on the same day that the Phase I ESA report was

officially released on August 28, 2000. The Phase II ESA report, issued in October 2000, gave more detail on acid-mine drainage in the area but presented no new information that significantly differed from that in the Phase I report or in DEP's files. In fact, the greater detail in the Phase II ESA report was, for the most part, obtained from DEP's files.

We question whether a Phase II ESA was necessary given the substantial evidence of acid-mine drainage in both DEP's files and in the Phase I report, and considering the Commonwealth's November 15, 2000, press release disclosing that outstanding concerns about potential liability for acid-mine drainage was responsible, in part, for management's abandoning the purchase. The information available to Commonwealth officials shows that they could have avoided paying the second $218,595 in earnest money to the sellers and the $13,200 for a Phase II ESA.

Regarding the opposition to this project noted in DMVA's press release, DMVA officials indicated that they did consider public opinion and believed that "public support for this project, by far, outweighed the opposition." Officials stated that "local political opposition escalated" after payment of the second five percent deposit. However, DMVA provided no evidence in their response to demonstrate overwhelming public support for the project, or that local political opposition significantly increased after May 2000, when the second earnest money payments were made.

Based on our reviews of press articles and other public correspondence, and our discussions with staff employed by the locally elected State Representatives, significant public concern about the proposed purchase site was communicated to DMVA prior to the commitment of funds for the purchase in December 1999. Furthermore, on November 30, 1999, just prior to executing the agreements of sale, DMVA management was invited by locally elected public officials to attend a public meeting to be held on December 15, 1999, for the purpose of discussing public opposition to the purchase site, but DMVA declined to attend. DMVA did not hold its own public meeting until April 6 and 7, 2000, over four months after the agreements of sale were signed and with less than two months remaining on the first reserve period.

DMVA's minutes of the April 6 and 7, 2000, public meetings revealed that many of the issues raised during the December 15, 1999, public meeting were not addressed. We noted that 125 people attended the December 1999 public meeting, and 156 questions (e.g., quality of life issues, impact on property values, safety issues, water pollution, sportsmen's issues, mine-related issues) were raised. None were addressed at the April 2000 meetings. Furthermore, the minutes recorded comments from only six individuals and did not include any DMVA responses to their concerns.

When we questioned DMVA about not attending the December 1999 public meeting and not holding its own public meetings until April 2000, DMVA responded that it followed the standard practice of holding a public forum in

accordance with the National Environmental Policy Act (NEPA). However, DMVA did not explain why it did not attend or hold public meetings prior to committing public funds for this project. We also noted that Goshen and Girard Townships formally adopted resolutions opposing the project on April 13, 2000, and May 11, 2000, respectively, or over 1½ months and 3 weeks prior to the end of the first 180-day reserve period. The April 13th resolution was passed one week after DMVA's own public meetings on the purchase. DMVA appears to have ignored public opposition to the purchase site prior to signing the agreements of sale and making the first earnest money payments, and to have ignored additional evidence of public opposition prior to making the second earnest money payments.

We asked DMVA officials for the source of the information in their press release that public opposition would have made it nearly impossible to obtain federal funding. DMVA did not answer our question and provided nothing to show that management actually verified that federal funding could not be obtained or that current federal funding would be reduced. In addition, DMVA stated that federal funds would have been pursued to support the "operations and maintenance" of the proposed facility. When questioned further about the federal funds to be pursued, DMVA indicated that they currently use a portion of their allotment of federal funds to pay for the transport of troops for training at other facilities in New York, Virginia and Kentucky. DMVA indicated that the federal funds currently used to transport troops to these out-of-state facilities would have been redirected to help offset operations and maintenance costs at the proposed training facility. These DMVA statements appear to indicate that no new federal funding was involved with this project, and the statements clearly contradict the press release of November 15, 2000, which stated that obtaining federal funding for the project would be impossible.

We also obtained other information which appeared to contradict, and therefore led us to question, DMVA's stated reasons in its press release for backing out of the purchase. For example, we reviewed a letter dated June 14, 2000, from DMVA to an individual who had asked whether the Commonwealth would be required to assume liability for existing acid-mine drainage problems if it closed on this purchase. DMVA responded, "If mine drainage continues following the expenditure of all available bond funds, and there is no remaining liability entity, the discharge would likely be considered the same as all other abandoned mine discharges in the study area. To our knowledge, owners of land on which mine discharges occur have not been held liable for treatment." DMVA thus contradicted the statement in its press release that "outstanding concerns about potential liability for acid-mine drainage" was a key reason for abandoning the land purchase.

In its response to our inquiry about this contradiction, DMVA changed its reason for not purchasing the property to the following:

. . . the potential for the National Guard to implement environmental management plans would have been greatly hindered without the full support of all local parties.

Between June and November the National Guard had no specific liability concerns. It was the local political opposition to the project, which became the cause for concern.

Recommendation

For any future real estate purchases, DMVA should strengthen internal controls to ensure that proper and timely consideration is given to potential environmental problems, public opinion, and the availability of federal funding for the project.

Management's Response

In its search for a location for a tracked-vehicle training area, the Department of Military and Veterans Affairs preferred mining land reclaimed to EPA industrial standards and requiring no significant clean-up. Consequently, the issues posed in the Department of Environmental Protection filings and in the studies completed by Gannett Fleming were neither unexpected nor insurmountable in the context of the land's intended use.

Based upon past project experience, the Pennsylvania National Guard reasonably believed that they would receive the necessary support to obtain federal funding for construction and maintenance of the tracked-vehicle maneuver training area. Their "good neighbor" reputation, led them to expect that they would be welcomed in any part of the state.

> ***"...I would give them a very high rating to any community they would have under reconsideration. They've been very supportive and contributed a lot to this area... As far as us and our business, they've been great. They account for about 90 percent of our business. And weekend training? That's excellent for our business."***
>
> **Allen Yingst, former Mayor of Annville, Lebanon County**
> **The Progress**
> **Clearfield, PA**
> **March 31, 2000**

Unfortunately, vigorous campaigning by an elected official from an adjacent district and other political opponents doomed the project for failure.

Ultimately, the Guard recognized that any vocal political opposition would make federal funding impossible, and therefore they decided not to continue with efforts to build a tracked-vehicle training area in Clearfield County. As a result, the National Guard and the nation lost a training facility, while the citizens of Pennsylvania (specifically

those in the Clearfield County) lost the economic advantages of Guard business.

Nevertheless, the Department of Military and Veterans Affairs has formed a Process Action Team (PAT) to examine processes and implement any additional procedures required to strengthen internal controls for future projects and land purchases.

Auditors' Conclusion

DMVA's formation of a Process Action Team is especially welcome given management's response, which offers no evidence that DMVA properly examined the environmental condition of the land, gave appropriate consideration to local public opinion, or adequately researched the availability of federal funding before committing public funds to the purchase. Our finding and recommendation that DMVA strengthen internal controls to ensure these procedures are in place remain as stated.

Additional Management Responses and Auditors' Conclusions

We have included after each finding those sections of management's written responses that specifically addressed that finding in a draft version of this final report. Management's responses also included additional comments which were general in nature and were not identified to a specific finding. These general responses follow, along with our additional auditors' conclusions.

Management's responses to the draft report are presented verbatim in this report, except when they resulted in our eliminating wording in the draft report from this final version of the report.

Additional Management Responses

The Auditor General's draft includes some valid criticisms, and we are already at work to improve our performance in those areas. Unfortunately, the observations are far outnumbered in the Auditor General's report by sensationalized findings.

The Auditor General's report systematically omits, misrepresents and de-emphasizes key factors in an attempt to portray this proposed transaction in an unfavorable light. When these factors are fairly represented, a very different picture appears.

- The Auditor General's report ignores Department of Military and Veterans Affairs' (DMVA) credentials to determine "that public opposition would have made it nearly impossible to obtain federal funding."

- The Auditor General's report inappropriately characterizes as "option money" what is actually a down payment or earnest money.
- The Auditor General's report accepts the word of political opponents in refuting the fact finding of nationally recognized environmental professionals.
- The Auditor General's report incorrectly characterizes environmental study results as "unsatisfactory."
- The Auditor General's staff failed to interview any Department of General Services' (DGS) personnel in the Bureau of Real Estate.
- The Auditor General's report unjustifiably presupposes that title impairments could not have been resolved prior to settlement.

The Departments of General Services and Military and Veterans Affairs are disappointed but hopeful that the Department of the Auditor General re-thinks the tenor of such findings in its final report.

The Pennsylvania National Guard began looking for a tracked-vehicle maneuver training site in the late 1980's during the Casey Administration.

Several sites in Schuylkill County were under review. The need for a maneuver training area increased dramatically in 1992 as the 28th Division was designated as a mechanized division by the United States Department of Defense to strengthen National Guard capabilities to augment active forces in time of armed conflict.

This new mission nearly tripled the number of tracked combat vehicles in the 28th Division. The Schuylkill County area search was abandoned in 1995 because of the large number of deep mines and land contours that were too restrictive for wide-ranging maneuvers.

At the same time, findings by both the federal Base Realignment and Closure Commission (BRACC) and the Governor's Base Retention and Conversion Public Action Committee (BRAC PAC) further confirmed that Fort Indiantown Gap lacked sufficient maneuver space to meet the new mission and increased demands of the 28th Division.

In concert with this study, the Adjutant General met with BRAC PAC officials to assist DMVA with finding a suitable maneuver training area. In turn, the BRAC PAC went looking for land that matched established criteria.

Attention then focused on Clearfield and Centre Counties as potential sites, because of the availability of land (specifically land that was environmentally reclaimed) and because it was a central location for Guardsmen across the state with access to rail and highway transportation as well as utilities. Visits were made to areas under consideration.

The Department of Military and Veterans Affairs was eminently qualified to choose the one best suited to meet the requirements of the Pennsylvania National Guard- the area that required the least effort to convert to a tank training facility, thereby serving the highest number of soldiers at the earliest possible date. DMVA's expertise resulted in the selection of the Walker-Hamilton-Lingle tract, and five related properties, in Clearfield County.

"The decisions on this property were made by good soldiers for sound training reasons alone," Lynch said, "and I concur with those decisions."

General William Lynch Pittsburgh Post Gazette March 8, 2000

The Auditor General's report goes to great lengths to document that there were environmental issues with the site. In reality, the site was going to be used by tracked vehicles and, thus, environmental issues, so long as they did not pose health or safety hazards, did not detract from the National Guard's ability to use the site for our soldiers.

The report cites a Commonwealth press release as documentary evidence that the Commonwealth had some grave concerns about environmental issues at the proposed tank-training site. In fact, our concern was not the environmental issues, but rather the demonstrated willingness of political opponents of the project to utilize marginal environmental issues to oppose the project, and thus cripple our ability to win federal funding.

A Phase I environmental site assessment (ESA) was conducted as a standard business practice. Although the Auditor General's report stated, "the Commonwealth also deemed the result of the ESA to be unsatisfactory," DMVA found the preliminary environmental assessment to be positive.

Nevertheless, at Gannett Fleming's recommendation, a Phase II ESA was also completed to ensure that all environmental matters were duly considered. On October 12, 2000, Gannett Fleming concluded, not surprisingly, that "acid mine drainage is present in Surveyor Run and Deer Creek." Furthermore, they noted "the proposed DMVA land uses for the site will not contribute to any worsening of the situation, and significant water quality improvements could in fact be realized through beneficial environmental management practices."

In light of these findings, there was no reason not to proceed with the purchase.

- It was the most suitable site to train our soldiers.
- The General Assembly by a vote of 177-20 had overwhelmingly approved and endorsed the purchase of land in Western Pennsylvania for a training area, appropriating $8 million for this purpose.
- No unanticipated environmental problems were encountered.
- The land was offered for purchase.
- Transportation and utilities were readily available.

"The Chamber has chosen to support the Pennsylvania National Guard and its endeavor to locate in this area. We believe it's good for Clearfield County. The money that they'll bring in will help the local merchants and general economy."

Gerry Hatcher, President, Chamber of Commerce
March 22, 2000 (This and all subsequent quotes are from The Progress, Clearfield, PA.)

"During the Gulf War, everyone would have been in favor of this. Now that peace is here, they don't want anything to do with it. Freedom of speech starts with military training."

Louie Carns, Resident, Clearfield
April 7, 2000

"Go ahead. Chase them off. Who's going to fight your wars?"

Calvin Martell, Resident, Girard Township
April 7, 2000

"I think we should vote on it and vote in favor of it. Maybe I grew up in a different world, but there is no way I could vote against what the Guard does."

George Owens, Director, Clearfield Area School District
May 16, 2000

"The Board could support the National Guard because there is no adverse impact and it will have a long-term economic benefit for Clearfield."

James Naddeo, President, Clearfield Area School District
May 16, 2000

"I was in World War II, even through the whole war, and didn't get a scratch. If I didn't have the proper training, it wouldn't have happened that way. Ninety percent of the people (protesting) have relatives, daughters, sons, neighbors, in the military. If they don't have the proper training, how are they going to defend this country?"

Robert H. Owens, Resident, Frenchville April 8, 2000

The Department of General Services negotiated with 13 landowners to purchase the property for the Pennsylvania National Guard. The agreed upon price was $4.7 million, only sixty percent of the $8 million authorized by the legislature.

As is common in private real estate transactions, the Commonwealth agreed to pay earnest money to all the sellers, so that the properties would be reserved during the title search, appraisals, and preliminary environmental studies. The earnest money totaled $437,190. In accordance with the sales agreements, amounts paid would have been applied against the overall price of each property. However, any decision by the buyer not to complete the transaction would result in forfeiture of the earnest money.

Despite this consequence, the transaction was never consummated. Why? Unforeseen - and unfortunate - political opposition to the site.

This political opposition had a particularly powerful effect on the project because, over the last year, momentum had been building in Washington for another round of military base closings. Even in the best of circumstances, this environment would make the job of securing federal funding for any new military facility difficult. With the addition of vocal political opposition, the task of obtaining federal funding would be impossible.

Guard officials work with Defense Department agencies and members of Congress on a daily basis to secure federal funds and carry out vitally needed military construction projects. Their competence is proven in some $30-$40 million worth of projects that are being successfully managed at any given time. They understand that the military construction process is lengthy and fraught with opportunities for adverse political intervention. As one

state legislator outside the affected area launched an orchestrated campaign of opposition, it became clear that further pursuit of the Clearfield County project would be futile.

Were it not for this purely political tactic, a tracked vehicle training area in Clearfield County could be a reality for the soldiers of the Pennsylvania National Guard.

"With the death of the 17 military personnel on the USS Cole, it should be evident that military maneuvers are important for military protection."

State Senator John Wozniak (D-Clearfield)
October 2000

With respect to the Auditor General's report, one fact is painfully clear: No training site exists in Clearfield County for the soldiers of the Pennsylvania National Guard, purely because of unwarranted political intervention.

"The tragic events that occurred Sept. 11, 2001, will be recorded as some of the worst in American history. The calamity of the event hit home with me when the plane crashed in Shanksville, PA. This small village is about the same size as many of the ones here in our area.

"This catastrophe could have happened anywhere. I could not help but think how much more comfortable I would feel if the Pennsylvania National Guard had located in our area. I question our local representative as to why he made it difficult for these protectors of freedom as our neighbors in Clearfield County.

"I'm hoping that the Pennsylvania National Guard has not left our region forever. We need them now more than ever. God bless America.

Linda Hatcher, Resident, Clearfield
September 25, 2001

Additional Auditors' Conclusions

We reject management's allegation that we sensationalized our findings and sought through illegitimate means to shed an unfavorable light on the procedures, decisions, and transactions we examined. Had this been the case, it would have been an easy matter for management to present information, explanations, or documentation to

refute each finding. For the most part, however, management has provided vague or irrelevant responses to detailed and documented findings. This approach is evident as well in management's additional remarks--that is, remarks that were not directed to specific findings--beginning with the six bullet points:

- DMVA's credentials for evaluating the impact of public opposition on federal funding are not at issue here. Our report simply questions why DMVA did not hold or attend public meetings before committing public funds to the project and making the first payment of earnest money, and why DMVA allowed the second payment to be made even after two townships passed resolutions opposing the purchase.

- We have already addressed the "option money"/"earnest money" dispute in our auditors' conclusions to the findings and in our final report.

- Since we never engaged in "refuting the fact finding of nationally recognized environmental professionals," we cannot discern the basis for management's statement here. Management also fails to explain the genesis of its assertion that "political opponents" were the impetus for this alleged refutation. We did, of course, rely on data from our own Commonwealth environmental professionals, the DEP, in presenting the long history of environmental concerns about the Walker property and in concluding that the sellers had breached the environmental clauses of the sales agreement. We also concluded that weak Commonwealth controls allowed a nonrefundable 10 percent of the purchase price to be paid without a proper examination of the environmental condition of the land.

- Our conclusions on the results of the ESAs are based on the ESAs themselves, the extensive documentation in DEP's files, and DMVA's November 2000 press release, which asserted that "…the second factor [in the decision to abandon the purchase] is our environmental concerns. Although the preliminary environmental assessment on the site proved generally positive, there are outstanding concerns about potential liability for acid-mine drainage." We believe that this statement was not an individual's off-the-cuff remark, but an agency's carefully prepared disclosure to the public of the reasons for abandoning a costly and lengthy project. (Note: In the draft report submitted for management's response, we used the term "unsatisfactory" to describe the environmental study results on the land for purchase. As explained in its response, however, management disagreed with the use of this term in describing the results of its environmental studies. As a result, we removed this term from our final report. We would like to point out, however, that the change in terminology had no impact on our conclusions in this report.)

- We cannot discern the point behind management's assertion that we failed to interview DGS personnel in the Bureau of Real Estate. If management is implying that we gave DGS insufficient opportunities to provide information relevant to our audit, the facts prove otherwise. We conducted entrance and exit conferences with DGS personnel, at which time they were invited to identify appropriate staff for us to interview, and to

provide and discuss pertinent information. In addition, we corresponded with DGS over a period of several months, asking detailed questions and making requests for information and documentation. We gave DGS staff ample time to respond, in writing or verbally. Finally, management had over 8 weeks to respond to the draft findings in our report. Unfortunately, DGS's responses during our audit were no more forthcoming than the responses of management that are made part of this final report.

- We do not presuppose that the title impairments could not have been resolved before settlement. We saw no evidence, however, of progress in this regard and no record of contacts with the title company to obtain the required title insurance. We do, however, believe that management had, and continues to have, the express legal right to void the Walker agreement based on title impairments. Notwithstanding the ambiguous contract provisions on recovering the earnest money, management also has the obligation to make whatever arguments it can to recoup these funds. In failing to pursue this matter, management itself is unjustifiably presupposing that marketable title is attainable and recovery of the earnest money is not.

We have already addressed most of management's additional comments either in the bullets above or in the individual findings in this report. As for the rest:

We do not dispute the qualifications of DMVA personnel to choose land that is best suited to the National Guard's needs. We do, however, stand by Finding #3, in which we identify significant weaknesses in the selection and procurement process. These weaknesses cast doubt--which has not been allayed by management's response--on whether the most suitable land was being acquired at the most reasonable price and whether public funds were judiciously expended.

The decision to abandon this purchase was management's responsibility. Opining on the correctness of this decision was not an objective of this audit. We certainly recognize that there was public support for the purchase as well as public opposition.

Management's insistence that "political opposition" was the sole reason for abandoning the project and losing over $400,000 in public funds does not agree with the record. In Finding #5 we related that public concerns about the proposed site were raised before the sales agreements were executed and continued throughout both reserve periods. Yet DMVA remained silent about its plans and apparently chose to ignore public concerns, moving forward on its own by committing substantial public funds to the purchase. Management's subsequent characterization of these public concerns as basely motivated "political opposition" and "purely political" tactics smacks of the sensationalism management has attributed to our report.

Finally, we acknowledge and understand management's disappointment that the National Guard is still without a tracked-vehicle maneuver training area. In our audit, we strove to discover and document what went wrong. Our

unavoidable conclusion is that Commonwealth officials mishandled the transaction in a number of respects, losing thereby both the property and hundreds of thousands of dollars in public funds. We are reporting these findings and making these recommendations to management so that the Commonwealth can avoid the same pitfalls in the future.

Attachment to Management's Response to Finding #4

Images of Letters and Agreements of Sale:

- Agreement Number One
- Agreement Number Two
- Agreement Number Three
- Agreement Number Four
- Agreement Number Five
- Agreement Number Six

AUDIT REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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The Honorable Victor J. Lescovitz

Department of Treasury
The Honorable Barbara Hafer
State Treasurer

Endnotes

[1]Act 45 of 1975 amended the Administrative Code of 1929 by, among other things, adding section 2401.1 (71 P.S.§ 631.1), which in paragraph (4) authorized DGS to "acquire land in the name of the Commonwealth….."

[2]The attachment to management's response showing November 30, 1999, as the date when the six agreements, with the sellers' signatures affixed, were forwarded to the Secretary of DGS does not document when the Secretary signed them.

[3]Management's execution dates for these contracts also fail to meet standard Commonwealth policy as set forth in Governor's Office Manual M215.3, entitled the "Field Procurement Handbook." Chapter 2 of the Handbook defines "Effective date" for a contract as:

> *A date fixed by the contracting officer which is after the date the contract has been fully executed by the contractor and by the purchasing agency and all approvals required by Commonwealth contracting procedures have been obtained. The contract shall not be a legal and binding contract until after the effective date is affixed and the contract is sent to the contractor.*
